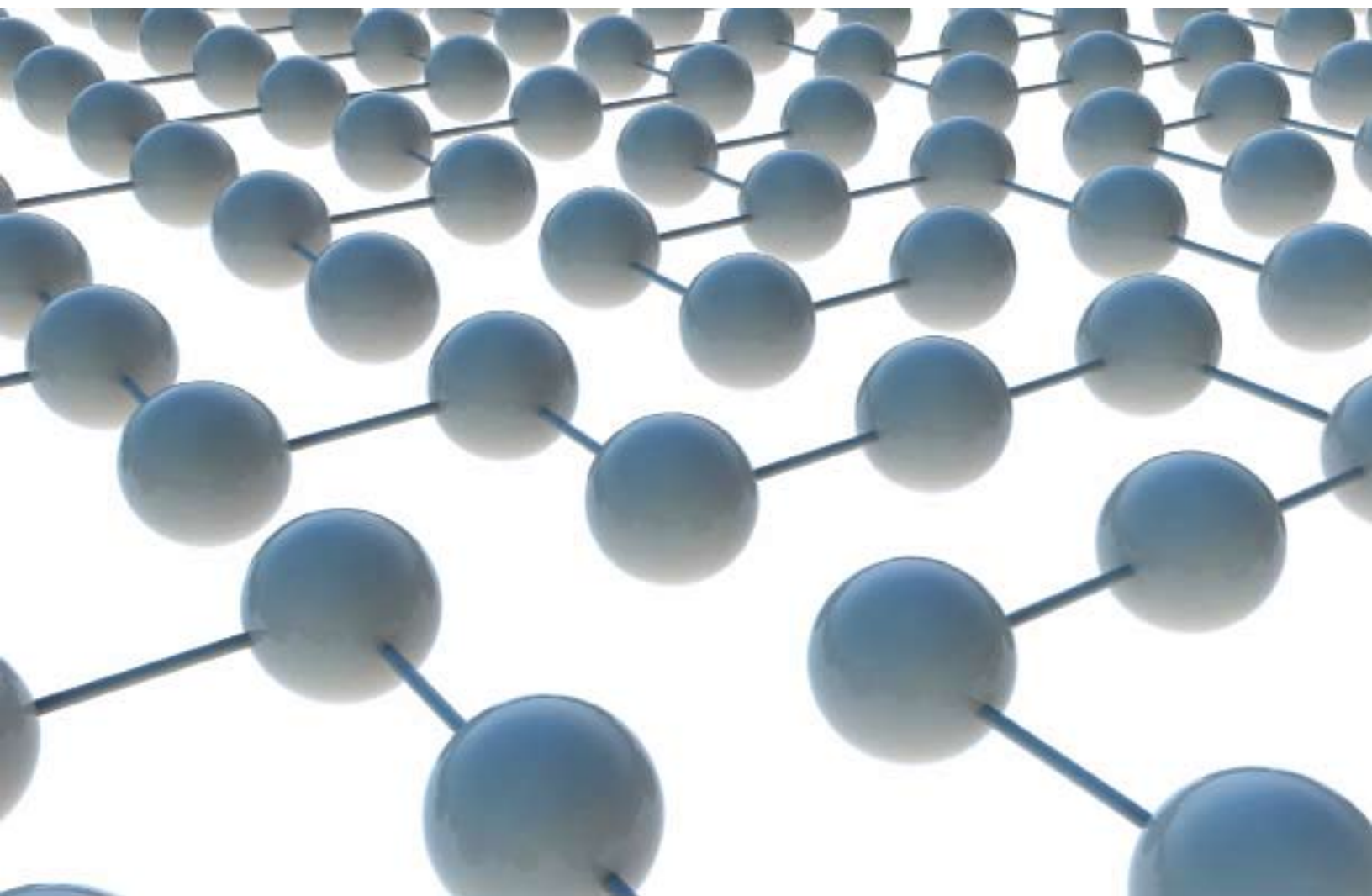


HR Outsourcing Trends and Insights 2009



About Hewitt Associates

Hewitt Associates (NYSE: HEW) provides leading organizations around the world with expert human resources consulting and outsourcing solutions to help them anticipate and solve their most complex benefits, talent, and related financial challenges. Hewitt consults with companies to design and implement a wide range of human resources, retirement, investment management, health management, compensation, and talent management strategies. As a leading outsourcing provider, Hewitt administers health care, retirement, payroll, and other HR programs to millions of employees, their families, and retirees. With a history of exceptional client service since 1940, Hewitt has offices in 33 countries and employs approximately 23,000 associates who are helping make the world a better place to work.

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About This Survey

In February 2009, Hewitt fielded a survey on HR outsourcing to learn how U.S. organizations manage their HR services and how strategies might be changing in the current economic environment.

In particular, we sought to learn the following:

- What motivates companies to outsource their HR services
- What HR services are most likely to be managed by outside providers
- What attributes companies look for when selecting HR service providers
- How companies measure the success of their outsourced HR services
- Whether the expectations of HR outsourcing align with the actual results
- How companies are responding to the weakened economy

We were pleased to have 104 organizations participate in the survey. Participants varied by size and industry. Approximately two-thirds of respondents are from publicly traded companies.

We conducted a similar trends survey in 2006 and, where appropriate, compare the results of the two surveys to provide insight into how employer attitudes about outsourcing are evolving.

Note: *In this report, “n” refers to the number of respondents to a specific question or portion of a question; the terms “organization,” “company,” and “employer” are used interchangeably; and values in tables and charts are rounded to the nearest whole number. Therefore, percentage totals may not add to exactly 100 percent.*

Key Survey Facts

- 71 percent plan to make no changes to their outsourcing strategy due to the weakened economy.
- 82 percent of responding companies indicated they have achieved the expected benefits from outsourcing (based on those who are able to evaluate their outsourcing progress).
- 58 percent said the top pressure facing HR is the need to reduce operating costs.
- 62 percent who identified cost reduction as a primary objective of outsourcing indicated that they met their costs savings objectives.
- 34 percent are more likely to outsource than they were 2 years ago.
- 81 percent rank improving service quality as the top method for measuring the ROI of an outsourcing initiative.
- 89 percent of companies have already outsourced their defined contribution program, while 72 percent have outsourced the administration of defined benefit plans and 61 percent their health and welfare plans.
- 73 percent are currently working on or recently completed HR process reengineering or a standardization project.
- 82 percent prefer to work with a partner who has in-depth domain expertise versus broad outsourcing experience, while 54 percent prefer to integrate and manage multiple HR services with one provider.

Executive Summary

Outsourcing Considered an Integral Part of HR Strategy

At a time when the majority of companies are under increasing pressure to reduce costs due to the weakened economy, HR departments expect to maintain their current strategies toward outsourcing HR services, according to Hewitt's *HR Outsourcing Trends and Insights 2009* survey. In fact, one-third of companies surveyed are more inclined to outsource today than they were two years ago—likely because outsourcing solves a number of challenges, including reducing costs and improving efficiencies.

From the survey results, it's clear that outsourcing does play an integral role in HR's ability to deliver programs to employees. Overall, 82 percent of companies said they realized the benefits they had hoped to gain by outsourcing (based on respondents who were able to evaluate their outsourced programs). More specifically, when asked to assess the success of outsourced HR services, at least 89 percent of respondents rated 25 of the 26 HR services as being effective or highly effective.

Participants indicated that outsourcing continues to solve a number of operational challenges for companies, and they consider it an effective part of their HR strategy. Furthermore, the demand for outsourcing is increasing, despite the bleak economy because it helps companies by:

- **Reducing costs:** Most organizations believe outsourcing can lead to lower costs. In fact, 65 percent of organizations that indicate cost savings is a primary outsourcing objective reported that they achieved their expected cost-reduction targets through their outsourcing programs. Interestingly, very few respondents indicate that they select their HR provider based on the lowest cost.
- **Gaining access to outside expertise:** In addition to needing specific domain expertise, companies also want to be relieved of the burden of making large investments in technology to maintain in-house systems and dedicating resources to meet challenging regulatory guidelines.
- **Improving service quality:** Considered the most common measure of success for outsourcing, 81 percent of respondents indicated that they met or exceeded their service quality targets.
- **Realigning/focusing on strategic HR priorities:** Outsourcing helps remove the day-to-day administrative of managing HR programs so HR can focus on delivering the business strategy and has more time to work with management on solving important business challenges.

Given the positive results companies are seeing from outsourcing, it should come as no surprise that close to three-fourths of companies reported that the recent economic conditions will not change their organization's outsourcing strategy. In fact, economic conditions are creating a new urgency for outsourcing. With the need to reduce costs, improve efficiency, and maintain high levels of employee service, HR should turn to outsourcing as a means to deliver greater value to the business.

Current Strategic Views on Outsourcing HR Services

“We look for ways to outsource services that can be done better and more efficiently than staffing that expertise in-house.”

“Economics are forcing us to work smarter and evaluate outsourced services if they provide a cost and/or functionality advantage.”

“As we conduct more research, it seems like it might be cost effective, and we should be able to provide better customer service to our employees if we outsource.”

“Legislation has made administration more complex, and more in-house expertise would be needed.”

“We are more inclined to outsource because our company has grown significantly in the past couple of years (due to acquisitions).”

“Complexity of environment makes it difficult (to outsource). (There is a) reluctance to change.”

“We are going through an HR transformation initiative reviewing the possibility of outsourcing other HR areas.”

“In 2008, more HR functions were localized, which in turn may lead to more outsourcing.”

“The main driver of outsourcing is compliance and efficiency.”

The Economy Takes Center Stage

HR strategy usually begins and ends with ensuring that the right talent is in place to effectively run your business. That was the case in 2006, when the top pressure for HR management was attracting, retaining, and growing talent. Today, managing talent has dropped to number four as reducing HR operating costs has become the top concern for HR management by a sizable margin. Meanwhile, there's a continued need for HR to focus available resources on supporting key business strategies.

Top Pressures on the HR Function

(Percentage ranking in top 3)

Past

2006, according to the 2006 survey:

1. Attract, retain, and grow talent (67 percent)
2. Better support business by focusing HR on strategic/core capabilities (47 percent)
3. Support business changes (41 percent)
4. Leadership development (38 percent)

Present

2009, according to the 2009 survey:

1. **Reduce operating costs (58 percent)**
2. Better support business by focusing HR on strategic/core capabilities (40 percent)
3. Support business changes (32 percent)
4. Attract, retain, and grow talent (28 percent)

Future

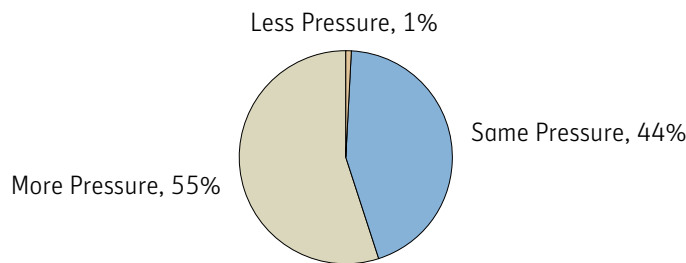
2010 to 2011, according to the 2009 survey:

1. Better support business by focusing HR on strategic/core capabilities (47 percent)
2. **Reduce operating costs of HR (44 percent)**
3. Attract, retain, and grow talent (38 percent)
4. Support business changes (34 percent)

Cost-reduction efforts are top of mind as HR is asked to reduce, eliminate, or put on hold HR initiatives that will save money in the short term while also minimizing the long-term negative impact on the business. The pressures related to the current economy and the increased focus on costs surfaced as primary themes throughout our survey results:

- More than one-half of companies are experiencing more cost pressures on their benefit programs than they were 12 months ago. As a direct result of these pressures, companies are looking to share more program costs with employees while others are streamlining and/or eliminating these programs altogether.

Cost Reduction Pressures on Benefit Programs Compared to 12 Months Ago



- The survey found that major HR initiatives—such as outsourcing—at most organizations improve efficiency and decrease costs, including HR process reengineering and the establishment of HR shared service centers.
- While survey respondents revealed that potential cost savings is one of the primary reasons organizations outsource HR services (78 percent), they also indicated that budgetary constraints are the most prevalent barrier to outsourcing (ranked in the top 3 by 57 percent). For organizations considering outsourcing, it's essential to define the business case and the return on investment (ROI) models required to ensure the program's success.
- Interestingly, though minimizing costs is noted as a top pressure on the HR function, very few organizations select their HR providers based solely on lowest cost.

HR Looks to Increase Efficiencies and Effectiveness Through Standardization of HR Programs

Organizational developments and ever-changing benefit programs combine to make managing HR programs an increasingly difficult proposition as HR is forced to navigate through nonintegrated technologies and disparate HR programs. The way to combat this complexity is by standardizing HR services and processes using technology to drive greater efficiencies while also delivering more effective programs for employees.

Nearly three-fourths of survey respondents indicated that process reengineering and standardization programs have recently been completed or are under way at their organizations. More than two-thirds have recently worked to upgrade their IT systems and/or have moved forward with implementing a new HR portal for employees. All these programs are designed to drive greater program consistency. There has also been an increase in the number of companies that have established an HR shared service center (60 percent of companies indicated a recent program has been started, an increase from 47 percent in 2006).

HR Initiatives Under Way or Recently Completed

	Percentage of Companies
Undertook HR process reengineering or standardization	73%
Implemented new HR IT system(s)	70%
Implemented a full HR portal with employee self-service and manager self-service	68%
Established HR shared service center(s)	61%
Outsourced 1–2 single HR processes (e.g., payroll, recruiting, pensions, or benefits administration)	53%
Implemented HR/benefits integration due to a merger or acquisition	46%
Outsourced multiple HR processes (3 or more) to a single HRO provider	24%
Sourced one or more HR process or HR service offshore	23%

(n=98; multiple responses)

Note: *Once the top four initiatives listed above are complete, percentages related to the remaining initiatives may increase accordingly.*

Outsourcing Practices and Perspectives

Prevalence and Effectiveness of Outsourced HR Programs and Services

A review of how companies elect to manage their HR services indicates that outsourcing has become the preferred delivery strategy for managing the primary benefit services. The majority of companies have chosen to outsource traditional benefit programs, including:

- Defined contribution (89 percent);
- Defined benefit (72 percent); and
- Health and welfare (61 percent).

This shouldn't be surprising considering these services are supported by proven delivery models and given the high transaction nature of these services. (See the table on page 10 for delivery prevalence data on 26 HR programs and services.)

With cost cutting at the top of HR's agenda, absence management and administering dependent audits led the group of HR-related services that companies plan to outsource in the near future. These services can directly impact a company's bottom line by ensuring that employees use their time off appropriately and accelerate return-to-work efforts and also by verifying the benefits eligibility of employees' dependents to reduce health care plan "leakage." Other interesting delivery themes:

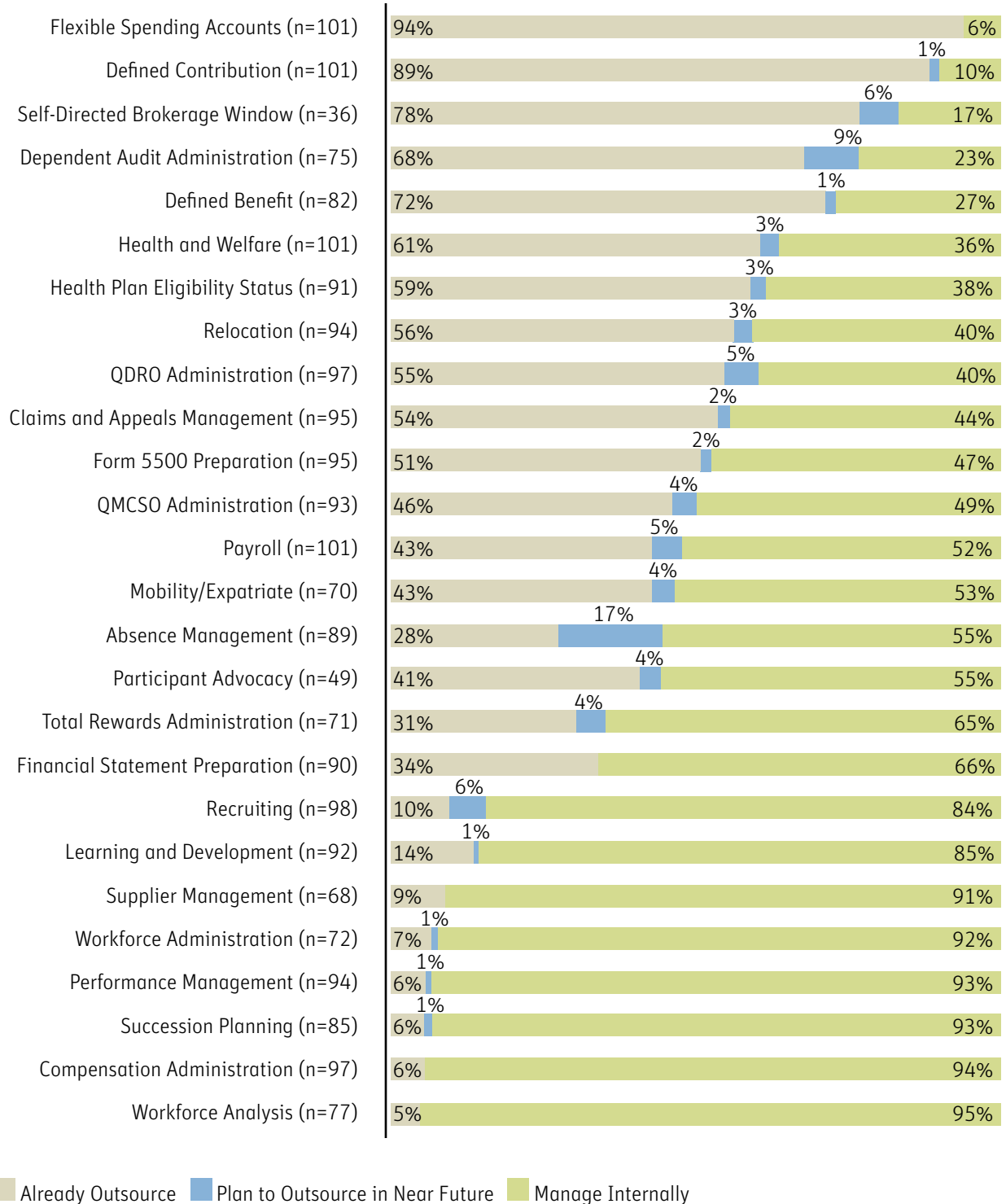
- Outside of the primary benefit services, there is no one preferred method of managing HR programs and services. In fact, quite the opposite: The percentage of companies that chose to outsource instead of managing services internally varies greatly.
- Flexible Spending Account (FSA) administration is already outsourced by 94 percent of respondents.
- The services more likely to be managed internally—including recruiting, supplier management, performance management, and succession planning—tend to be more specialized in nature, aren't as transactional, and have less mature delivery models.

Outsourcing Delivers Results

Every company is unique, and models for delivering HR services vary. However, the overwhelming belief from survey respondents is that outsourcing HR services delivers the expected results. A review of the data shows the following:

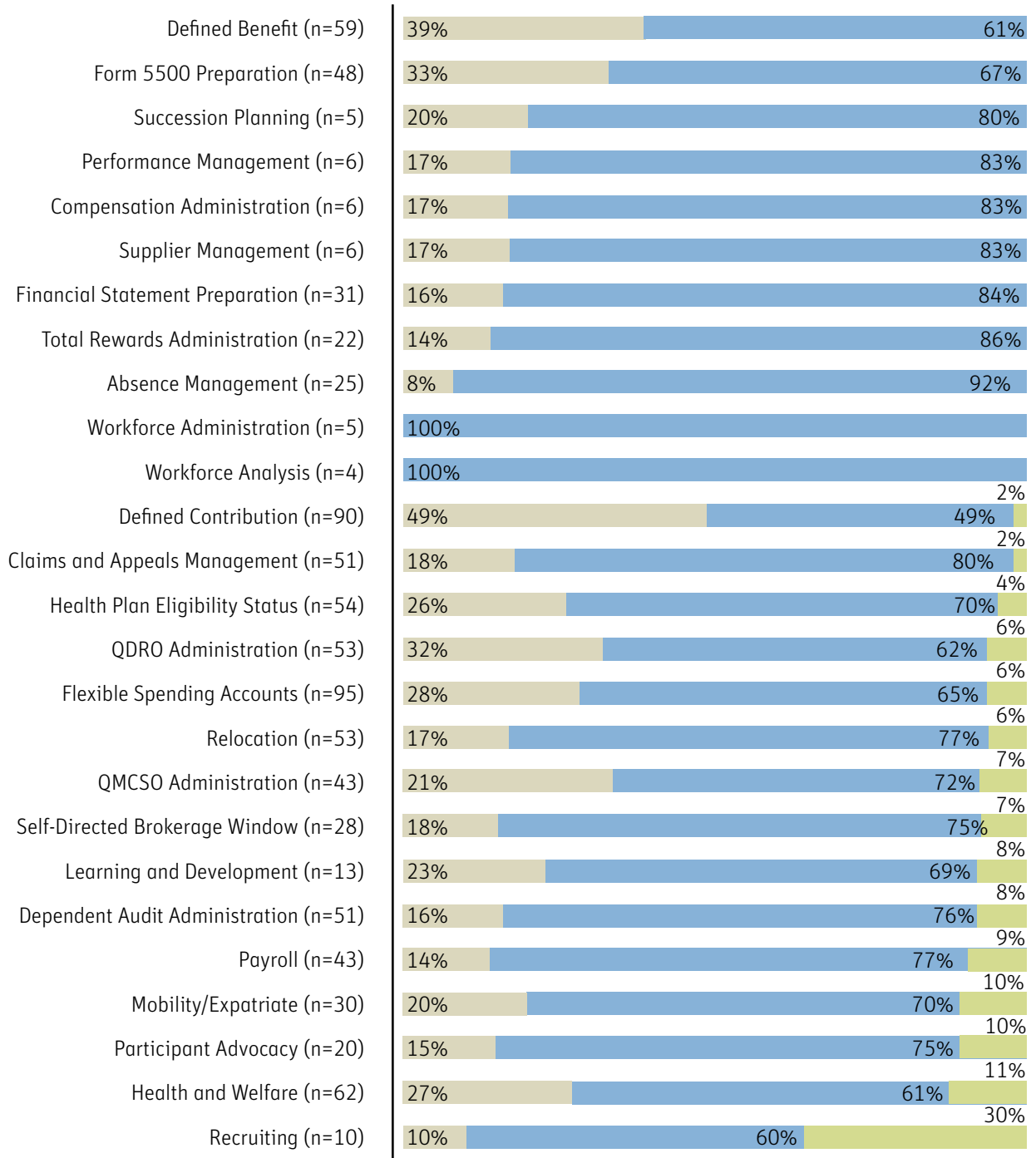
- At least 89 percent of respondents rated nearly all programs and services as highly effective or effective.
- Nearly one out of every two companies that outsource their defined contribution administration rated the program as highly effective—with a combined 98 percent rating their defined contribution service as effective or highly effective.
- The other primary benefit services also received high satisfaction grades:
 - 88 percent rated their outsourced health and welfare services as effective or highly effective; and
 - 100 percent rated their defined benefit programs as being effective or highly effective.
- A number of other HR programs and services that weren't outsourced as frequently received consistently favorable feedback from survey respondents. This might indicate that more companies will consider outsourcing these services in the near future. They include:
 - Compensation administration;
 - Performance management;
 - Total rewards administration;
 - Succession planning; and
 - Workforce analysis.

Prevalence of Outsourced HR Programs and Services



Note: Percentages depicted by each bar of the above table include only companies that offer that type of program or service; participants selecting “no such program/service” were not included in that breakdown.

Effectiveness of Outsourced Programs



Highly Effective
 Effective
 Not Effective

Why Companies Are Motivated to Outsource HR Services

Outsourcing helps alleviate the administrative burdens associated with managing complex HR programs. In addition, research confirms that HR outsourcing also provides organizations with the ability to lower costs, gain access to better expertise, improve customer service, and enable HR to deliver greater value to the organization. These motivating factors to outsource HR services remained consistent with our research findings from 2006.

Top Reasons for Outsourcing HR Services		
	2009	2006
1. Opportunity for cost savings	78%	74%
2. Access to outside expertise	78%	65%
3. Improve service quality	74%	74%
4. Realign resources/focus on strategic HR priorities	72%	62%
5. Relief from regulatory/administrative burdens	70%	46%

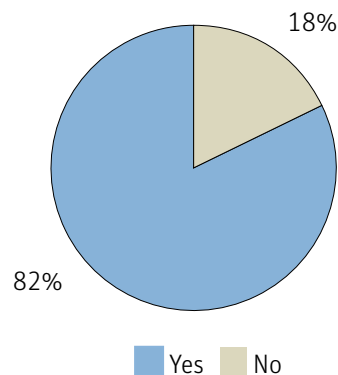
Note: Percentages reflect the percentage of companies rating each as a 4, 5, or 6 on a scale where 1=Not at All a Reason for Outsourcing and 6=Key Reason for Outsourcing.

One factor that appears to be growing as a motivating factor for companies is the opportunity to alleviate regulatory/administrative burdens. Increased regulatory demands are likely the cause behind 70 percent of respondents citing this as a key reason to outsource, compared with only 46 percent in 2006.

Outsourcing Delivers on HR Objectives

A strong majority (82 percent) of organizations that have measured their outsourcing program outcomes indicated that they realized the benefits they had expected to gain by outsourcing. This is an increase from the 2006 survey findings when 70 percent of respondents reported that their outsourcing programs met their objectives.

Realize Benefits From Outsourcing?



How Outsourcing Success Is Measured

With budget pressures mounting, it’s more important than ever to measure the success of your outsourcing programs. Nearly all survey respondents reported that their organization gauges ROI of their outsourcing program using at least one of five predefined measures, and many companies measure ROI using a number of factors. Twenty-two percent of participants use all of the top five measures, while 27 percent use at least four of the metrics to gauge their outsourcing success.

Worth noting is that for just under half of responding companies, the success of HR outsourcing is not measured by the company’s ability to realign or reduce HR staff.

Measuring the ROI of HR Outsourcing

	Percentage of Companies Using Measure
Improved service quality	81%
Improved operational efficiencies	79%
Reduced operating costs	70%
Improved employee satisfaction	65%
HR staff realignment and/or reduction	48%

(n=102; multiple responses)

There’s strong evidence to support the premise that HR outsourcing is working. At least three-fourths of companies indicated that they met or exceeded their set targets for each of the measures used to gauge ROI.

Measuring the Level of Success of HR Outsourcing

	Level of Success Against Measures <small>(At Companies Where Measure Is in Use)</small>		
	Exceeded Expectations	Met Expectations	Did Not Meet Expectations
Improved service quality	5%	76%	19%
Improved operational efficiencies	9%	77%	15%
Reduced operating costs	3%	75%	23%
Improved employee satisfaction	8%	70%	23%
HR staff realignment and/or reduction	2%	76%	22%

Barriers to Outsourcing

Despite the clear advantages to outsourcing HR services, nearly half of survey participants said that barriers to outsourcing do exist within their organization. According to those who indicated barriers exist, the most prevalent barrier is the lack of available budget (selected by 57 percent of participants as one of the top three barriers). Slightly more than half of respondents also indicated having difficulties building a proper business case, while concerns about losing control of key processes was also cited as a barrier by 47 percent of respondents.

In today's challenging economic environment, it shouldn't be a surprise that one-third of respondents who cited a lack of budget as their top barrier also mentioned having difficulty building a business case as their next biggest concern. Companies that are considering outsourcing their HR services will have an easier time getting business case approval if their ROI metrics are clearly defined up front.

Since we conducted this survey in 2006, companies appear to have become more comfortable releasing control of their HR programs to business partners and in managing these providers—both of which are core elements to successful outsourcing relationships.

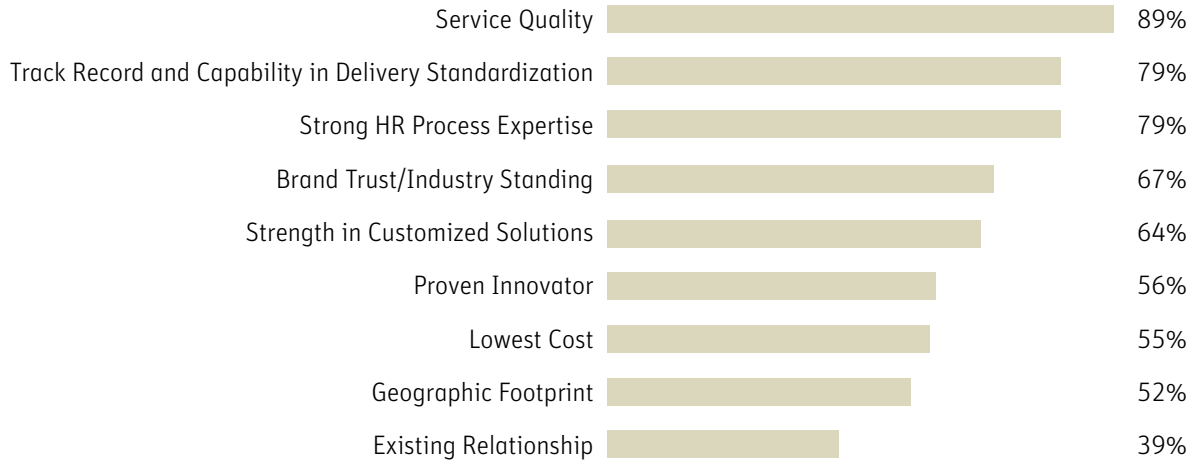
- In 2006, concerns about losing control of key processes were the top barrier, with 32 percent of respondents selecting it as their organization's top barrier to outsourcing. In this year's survey, only 12 percent ranked it first.
- While 43 percent of participants ranked concerns about vendor management in the top three barriers in place at their organizations in 2006, that figure dropped to 20 percent this year.

Barrier	Percent Ranking as One of Top 5
No budget available	78%
Concerns about losing control of key processes	76%
Difficulty building a business case	71%
Concerns about vendor management	51%
Concerns about employee reactions to an external service provider	47%

Picking an Outsourcing Partner

There are a number of capabilities that companies seek when selecting an outsourcing provider to administer their HR services. First and foremost, companies that may be outsourcing for the first time want to ensure that the selected provider will be able to meet or exceed quality expectations. They also want a provider with proven experience in driving standardization in service delivery throughout their organizations. Somewhat surprisingly, respondents aren't as motivated to select a provider based on the lowest cost, as that component ranked seventh among the list of decision criteria.

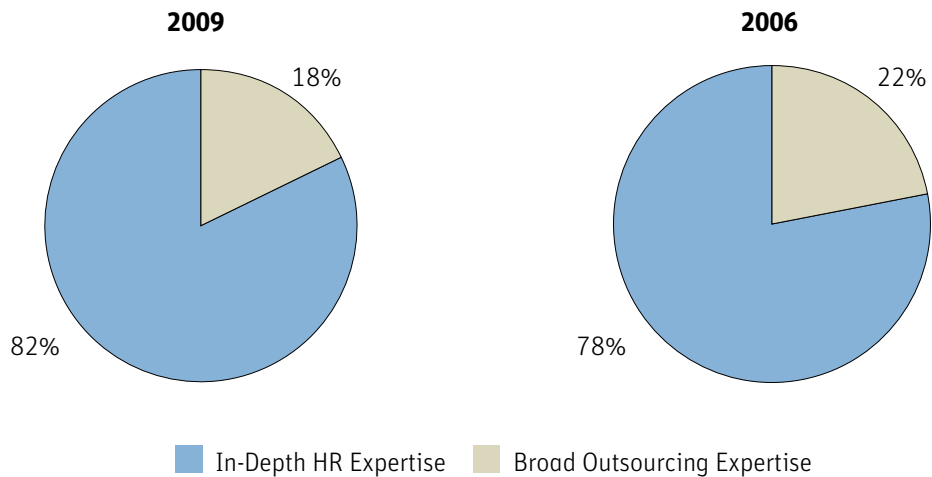
Top Factors in Choosing an Outsourcing Provider



Note: Percentages reflect the percentage of respondents selecting 1 or 2 on a scale of 1 to 5, with 1=Very Important and 5=Not Considered.

According to the survey, in-depth HR expertise continues to be valued over broad outsourcing expertise when selecting an outsourcing partner. Before handing over their HR programs to an outside provider, companies want to know that their outsourcing partner can not only deliver their programs more efficiently, but also more effectively—helping to transform the HR functions.

**Background Experience Sought in a Third-Party Administrator:
In-depth HR Expertise vs. Broad Outsourcing Expertise**



Participant Profile

Participants varied by size and industry. About two-thirds of responding companies are publicly traded.

Number of Employees in Participant Organizations

	Percentage of Organizations
Less than 3,000	22%
3,001 to 15,000	39%
15,001 to 30,000	13%
30,001 to 50,000	12%
50,001 to 100,000	6%
100,000+	8%

(n=104)

Industry Breakdown

	Percentage of Organizations
Diversified manufacturing	10%
Automotive/transport manufacturing	4%
Banking	2%
Business services	2%
Chemicals	3%
Computer services	1%
Conglomerate	1%
Construction	1%
Consumer products manufacturing	6%
Education	1%
Energy/utilities	7%
Entertainment/communications/publishing	3%
Financial services	11%
Food	2%
Government	1%
Health care	7%
Industrial manufacturing	5%
Insurance	5%
Media	2%
Member organizations	1%
Metals/mining	1%
Pharmaceuticals	2%
Retail (includes wholesale and distribution)	6%
Telecom (equipment and services)	2%
Transportation services	2%
Other (specify)	15%

(n=104)

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